

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
of	:	
MAPLE LEAF MOTOR LODGE, INC.	:	DETERMINATION
AND RUDOLPH J. BERSANI AND DAVID R. BERSANI,	:	
AS OFFICERS	:	
for Revision of a Determination or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Period March 1, 1981	:	
through February 29, 1984.	:	

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Petitioners, Maple Leaf Motor Lodge, Inc. and Rudolph J. Bersani and David R. Bersani, as officers, 1620 Niagara Falls Boulevard, Tonawanda, New York 14150, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1981 through February 29, 1984 (File No. 801462).

A hearing was commenced before Timothy J. Alston, Hearing Officer, at the offices of the State Tax Commission, 65 Court Street, Buffalo, New York, on May 21, 1987 at 9:15 A.M. and continued to conclusion at the offices of the Division of Tax Appeals on November 17, 1987 at 9:15 A.M., with additional evidence to be submitted by December 8, 1987. Petitioners appeared at the May 21, 1987 hearing by Borins, Setel, Snitzer and Brownstein (Joel Brownstein, Esq., of counsel) and at the November 17, 1987 hearing by David R. Knoll, Esq. The Audit Division appeared at the May 21, 1987 hearing by John P. Dugan, Esq. and at the November 17, 1987 hearing by William F. Collins, Esq. (Deborah J. Dwyer, Esq., of counsel).

ISSUES

I. Whether petitioners have established that the Audit Division's determination of additional taxable restaurant sales was erroneous, either in the audit methodology employed or in the results achieved.

II. Whether petitioners have substantiated the nontaxable status of certain motel room rental receipts.

FINDINGS OF FACT

1. Petitioner Maple Leaf Motor Lodge, Inc. ("Maple Leaf") operates a motel and attached restaurant, named Three Coins Restaurant. Petitioner Rudolph J. Bersani was the president of Maple Leaf and was generally in charge of the business and financial aspects of operating the restaurant and motel. Petitioner David R. Bersani was the vice president of Maple Leaf. He was responsible for certain of the day-to-day tasks involved in operating the business. David Bersani also owned his own motel, situated near the Maple Leaf Motor Lodge.

2. An audit of Maple Leaf began in March 1984. The Division of Taxation sent a letter to Maple Leaf attempting to schedule an audit appointment. The letter requested that Maple Leaf make available to the Division all books and records pertaining to Maple Leaf's sales tax liability,

including: "journals, ledgers, Sales invoices, purchase invoices, cash register tapes, exemption certificates and all Sales Tax records [sic]." As the Division did not receive a response to this letter, it sent a second similar letter to Maple Leaf dated May 3, 1984.

3. Rudolph Bersani was in Florida when the Division's second letter was received by David Bersani. Upon Rudolph's return to New York, he contacted the Division and arranged for a meeting at the Division's offices on or about June 5, 1984.

4. At the June meeting, the Division explained the audit procedure and requested that books and records for the audit period be made available for review. Petitioners provided the auditor with sales tax returns, Federal and State income tax returns with related workpapers, depreciation schedules, a cash receipts journal covering a portion of the audit period, a check disbursements journal and purchase invoices for a designated test period.

5. At the time of the audit, the Division believed that the motel and restaurant owned by Maple Leaf had been sold in a bulk sale. The statute of limitations for assessing the purchaser in this purported sale would have expired on June 20, 1984. Although complete records of sales were not provided to it, the Division decided to proceed with an audit using available information so that an assessment could be issued before the expiration of the statute.

6. The auditor compared Maple Leaf's income tax returns with its sales tax returns. This comparison disclosed that gross receipts reported by Maple Leaf on its Federal corporation income tax returns were greater than taxable sales reported on its State sales tax returns. Worksheets accompanying the Federal returns showed that the discrepancy came about because Maple Leaf reported as gross receipts rental income which was not reported as taxable sales. Maple Leaf divided rental income into several categories: transient motel guests, permanent motel guests, apartments, houses and office space. Only receipts from transient motel guests were reported as taxable sales. Because petitioners produced no documentation to substantiate the nontaxable status of the other rental receipts, the auditor determined that these receipts were additional taxable sales, totaling \$1,223,169.00 for the audit period.

7. The auditor performed a test period and purchase markup audit of the restaurant's food, liquor and wine, and beer sales.

(a) Initially, the auditor performed an audit of food sales for the test period August 1983. From the purchase invoices, the auditor listed items used to prepare dinner entrees, such as chicken breasts, prime rib and lobster. He then calculated the quantity of each item purchased, by weight. Allowances of 20 to 60 percent were applied to total pounds of each item to account for shrinkage and spoilage. The remaining poundage was divided by an average serving size, as estimated by Rudolph Bersani. The resulting figure showed the average number of dinners which could be served from the purchases made in the test period. The selling price of each dinner item was taken from a menu. This price was applied to the number of dinner items to obtain total sales. Total sales as calculated by this method were divided by total purchases, resulting in a food markup of 91 percent<sup>1</sup>. Since purchases exceeded sales the auditor considered

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<sup>1</sup>In accordance with the Division's guidelines, the actual markup was a negative figure. A markup percentage is determined by subtracting purchases from sales and dividing the result (gross profits) by purchases. To obtain gross sales, the markup percentage is applied to purchases to

this markup to be unrealistically low and disregarded it.

(b) Rudolph Bersani provided the auditor with summaries of restaurant sales for June, July and August 1983. These summaries were prepared by Mr. Bersani from daily sales records kept in the normal course of business. It was Mr. Bersani's practice to record, in the category of food sales, food sales (shown as gross sales), food sales paid for by the customers with a discount or two-for-one coupon (shown as discount, coupon sales) and the value of food given to customers without charge (shown as house charges). Sales tax was collected only in the first category. Maple Leaf's records showed gross sales of \$36,890.69 for the test period. Purchases for that period were determined to be \$32,992.35. Thus, Maple Leaf's records showed a markup of 112 percent. However, the auditor recalculated taxable sales by including discount and coupon sales and house charges. This was done because no documents were available to substantiate the nontaxable status of these sales. The auditor calculated taxable food sales for the three-month test period of \$69,782.20. Sales were divided by purchases to calculate a markup of 211 percent.

(c) The auditor asked Rudolph Bersani to complete a bar fact sheet. The auditor completed those portions of the form which asked for a statement of the types of drinks served. He listed two possible categories. Bar blends and call brands constituted one category, and premium brands constituted the other. Where the form called for a listing of grades of beer served, the auditor filled in three possible categories: domestic, imported and premium. For each of the categories listed on the form by the auditor, Rudolph Bersani provided serving sizes and selling prices. The form lists selling prices in three possible subcategories: regular, happy hour and entertainment. Mr. Bersani gave prices for each subcategory. In the categories of domestic and imported beers, Mr. Bersani indicated that all sales were of draft beer in 12-ounce glasses. Only two premium beers were shown on the fact sheet, Miller Light and Budweiser.

(d) From the information shown on the bar fact sheet, the auditor calculated average selling prices as follows:

<u>Type of Drink</u>	<u>Service Size (in ozs.)</u>	<u>Average Selling Price</u>
Bar blends and call brands	1.75	\$1.33
Premium brands	1.75	1.58
Domestic beer	12	.75
Imported beer	12	.75
Premium beer	per bottle	1.50

(e) Mr. Bersani told the auditor that wine was sold in five-ounce servings. The auditor

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obtain gross profits and purchases are then added back to the result. The auditor's methodology was essentially a shortcut that allowed him to calculate gross sales directly by applying the percentage he called a markup to purchases. The auditor's "markup" figures are consistently 100 percent higher than an actual markup. Petitioners adopted the auditor's methodology in calculating their own "markups". In the interests of consistency, this determination has adopted the terminology used by the parties.

reduced the serving size to four ounces to allow for ice. Generally, a selling price of 75 cents per serving was applied to wine purchases.

(f) From the serving sizes and prices described above and the purchase invoices, the auditor calculated total wine and liquor sales in August 1983 of \$24,055.59 and total beer sales of \$10,448.62. Sales were divided by purchases to obtain markups of 325 percent on wine and liquor and 345 percent on beer. In calculating these markups, the auditor gave an allowance on purchases of liquor, wine and draft beer to allow for spillage, breakage and other losses. No allowance was given on bottled beers.

(g) Calculated markups on food, wine and liquor, and beer were applied to purchases in those respective categories for calendar years 1982 and 1983. The resulting audited taxable sales were compared to reported taxable sales to obtain an error rate of 51.13 percent. The error rate was applied to reported taxable sales to calculate additional taxable sales of \$824,758.00.

8. On June 18, 1984, as a result of this audit, the Division issued to Maple Leaf, Rudolph J. Bersani and David Bersani three identical notices of determination and demands for payment of sales and use taxes due for the period March 1, 1981 through February 29, 1984, assessing tax due of \$143,354.89 plus penalty and interest. The notices to Rudolph Bersani and David Bersani explained that each, as an officer of Maple Leaf, was personally liable for taxes due from the corporation.

9. A routine review of the audit workpapers completed after the assessment was issued disclosed a mathematical error in the calculation of tax due on receipts from rentals. Correction of the error resulted in a determination of total tax due for the audit period of \$124,684.14. A later review of the workpapers disclosed an error in the calculation of taxable food sales. The corrected total was determined to be \$55,645.45, and the correct markup was determined to be 168 percent.

10. At a Tax Appeals Bureau conference, petitioners presented additional documentation which the Division accepted as warranting several adjustments to total audited taxable sales.

(a) Maple Leaf accepted Canadian money at face value although the value of a Canadian dollar was slightly less than that of an American dollar. On its Federal income tax return, Maple Leaf deducted the differential from total income. Using bank statements to substantiate deposits of Canadian dollars, the auditor reduced reported taxable sales for each quarter in the audit period. Since additional taxable sales were later calculated by the application of an error rate to reported taxable sales, reduction of reported taxable sales resulted in a reduction of tax due.

(b) Purchases for the test period of June, July and August 1983 were reduced by non-food items such as napkins, ashtrays and silverware. The resulting food purchases were divided by sales (adjusted for the discount on Canadian dollars) to calculate a markup on food purchases of 156 percent. This markup was applied to food purchases made in calendar years 1982 and 1983. The previously calculated markups on liquor and wine and beer were applied to purchases in their respective categories for the same years. This resulted in total audited taxable restaurant sales of \$1,190,785.42. To this amount were added taxable receipts from motel room rentals, as reported by Maple Leaf. The total was \$1,377,592.59. Reported taxable sales were subtracted from this total to calculate additional taxable sales of \$334,770.23. An error rate of 32.10 percent was calculated by dividing additional taxable sales for 1982 and 1983 by reported taxable sales for the same period. The error rate was applied to net taxable sales (i.e., reported taxable

sales adjusted to allow for sales in Canadian dollars) to determine additional taxable sales of \$509,033.57.

(c) Petitioners substantiated that a portion of their rental income was from the rental of office space. Accordingly, the Division eliminated these receipts from its calculation of taxable sales.<sup>2</sup>

(d) To calculate total additional sales and purchases subject to sales tax, the auditor added additional taxable sales (see Finding of Fact "10[b]"), purchases of non-food items subject to sales tax of \$6,456.10, receipts from permanent motel sales of \$493,129.00 and receipts from apartments of \$171,665.00. The sales tax rate was applied to the result to obtain additional tax due of \$82,619.86. This was the total amount of tax due asserted by the Division at hearing.

11. Maple Leaf kept its books and records in the restaurant's basement. In February 1984, the restaurant's fire escape broke through the roof of the restaurant leading to flooding in the basement. Many of the business records were damaged in the flood.

12. In April 1984, Maple Leaf leased the land and premises of the motel and restaurant to Richard Snowden. While Mr. Snowden was in control of the premises, he refused to allow the Bersani's to enter the property to search for books and records. Mr. Snowden and his company eventually entered into bankruptcy and were evicted from the property owned by Maple Leaf. The second person to lease the property allowed Rudolph Bersani access to the restaurant's basement. In June or July 1987, Mr. Bersani searched the basement and located some books and records unavailable at the time of audit. Other records were discovered to be water damaged or missing.

13. Maple Leaf Motor Lodge was located on Niagara Falls Boulevard, an area filled with motels and restaurants. The motel's business fluctuated greatly from the summer tourist season to the winter season. To compensate for these fluctuations, Maple Leaf rented motel rooms and suites on a monthly basis to permanent lodgers.

14. Worksheets accompanying Maple Leaf's Federal income tax return for 1982 showed rental income from permanent guests of \$185,163.00 and rental income from apartments of \$59,880.00. Worksheets accompanying Maple Leaf's Federal income tax return for 1983 showed rental income from permanent guests of \$143,631.00 and rental income from apartments of \$56,600.00.

15. At hearing, petitioners introduced rent rolls for August 1983 showing rentals of rooms, apartments and homes to permanent guests. The rolls show the apartment or room number rented, the monthly rental amount and the guest's name. Partial rent rolls were also submitted for September, October, November and December 1983. Eleven affidavits were submitted, substantiating the accuracy of the August rent rolls as they applied to those eleven guests. Five persons testified at hearing that either they or someone personally known to them were permanent residents of the Maple Leaf Motor Lodge during the periods at issue. The rental income shown on the monthly rent rolls was consistent with amounts reported by Maple Leaf on its 1983 corporation income tax return.

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<sup>2</sup>The Division's calculations show that house rentals were also excluded from taxable sales, although the basis for this adjustment is not stated in the record.

16. Petitioners established that several errors were made in the auditor's markup of liquor and wine. Several lower priced call brands of liquor (e.g., Black Velvet, Smirnoff vodka and Canadian Club) were treated as premium liquors; some wines were miscategorized as liquors; and sparkling wines and champagnes were marked up by the glass, although they were sold only by the bottle. All bottled beers were treated as premium beers.

17. At hearing, petitioners presented their own markup audit of food, liquor and wine, and beer sales for the test period August 1983. The audit was performed by Rudolph Bersani using Maple Leaf's books and records, his personal knowledge of the business, the auditor's workpapers and field audit guidelines issued by the Division.

18. The markup on beer, wine and liquor performed by Rudolph Bersani duplicated the auditor's methodology as described in Finding of Fact "7"; however, Mr. Bersani made the following adjustments:

(a) Bottles of Cribari champagne were given away as a promotion. They were rarely sold. Therefore, Cribari champagne was eliminated from sales. Other sparkling wines were marked up by the bottle rather than the glass.

(b) While Maple Leaf was operating the restaurant, Mr. Bersani, the restaurant manager and the bartender conducted periodic surveys to evaluate the impact of pricing specials. Newspaper advertisements establish that the restaurant conducted frequent drink specials. Using his own personal knowledge, Mr. Bersani determined the following price schedule:

<u>Type of Drink</u>	<u>Percentage Sold at Indicated Price</u>	<u>Selling Price</u>
Cocktails	100	\$1.33
Other liquors	35	.50
	35	.99
	16	1.50
	14	1.75
	25	2 bottles for .75
Regular bottled beer	38	1.00 per bottle
	22	1.25 per bottle
	15	1.50 per bottle
	25	2 bottles for 1.75
Premium beer	38	1.25 per bottle
	22	1.50 per bottle
	15	1.75 per bottle
	25	.50
Draft beer	38	.50
	22	.75
	15	1.00
	33.3	.50
Wine	66.7	.75

(c) Based upon a measurement of bar glasses used during the test period and his personal knowledge, Mr. Bersani used the following serving sizes: 3.5 ounces for cocktails (20% of all bar drinks), 1.75 ounces for other liquors, 12 ounces for draft beers and 5.5 ounces for wine.

(d) A 15 percent allowance was applied to all purchases for spillage and breakage.

19. Mr. Bersani's analysis resulted in a markup on liquor and wine of 206 percent and a markup on beer of 234 percent.

20. Three Coins Restaurant participated in several discount or two-for-one meal programs. Maple Leaf had a contract with Entertainment Coupons, Inc. and the Dinner-for-Two-Club. The restaurant itself placed advertisements in the local newspapers which included discount coupons. In 1981, the Bersani's purchased a tent theater production facility known as Melody Fair. At the time of purchase, approximately \$375,000.00 in unused Melody Fair tickets were held by approximately 4,000 individuals who purchased the tickets before the facility's closing. As a gesture of goodwill, the Bersani's agreed to exchange each ticket for a one-year membership in the Melody Park Society Club. Along with other benefits, members received \$5.00 off every dinner check for two at the Three Coins Restaurant.

21. Maple Leaf employed a full-time bookkeeper named Thomas O'Toole. Mr. O'Toole's duties included nightly verification of the restaurant's guest checks and the preparation of a nightly summary sheet. Each waiter or waitress completed and signed a record of guest checks, enabling Mr. O'Toole to account for all guest checks distributed. If a customer presented a discount coupon, the entire menu price of all items purchased was entered on the guest check, and all the items were totaled. The amount of the discount was then subtracted, and sales tax was collected on the remainder. At the cash register, the cashier would ring up the total of all menu items and enter the amount of the discount as a void. Coupons were stapled to those cash register receipts showing a void. Mr. O'Toole reviewed the guest checks and cash register tapes to ensure that all discounts were properly accounted for, that the correct prices were entered on the guest checks, and that the guest checks were accurately totaled. The summary sheet he provided to Rudolph Bersani accurately stated restaurant gross sales and sales from discount coupons.

22. Three Coins Restaurant provided free midnight buffets every Monday night. It served cold cuts, macaroni, salads and relishes to approximately 175 people at a cost of approximately \$1.93 per person. Nightly, it served free appetizers, such as cocktail wieners and chicken wings, during the 4:00 P.M. to 7:00 P.M. cocktail hours.

23. Employees of the restaurant were provided with free meals. The value of meals received qualified as income under Federal minimum wage guidelines. In 1983, the Federal guidelines allowed Maple Leaf an allowance of \$1.15 per meal.

24. At hearing, petitioners introduced a sales ledger for calendar year 1983. It showed gross restaurant sales for the year of \$595,003.28. Deducted from this amount were coupon, discount sales of \$76,402.20, house charges of \$28,436.70 and sales tax of \$32,066.90. These figures show that approximately 23 percent of the restaurant's total sales were nontaxable food giveaways.

25. The 1983 sales ledger shows total liquor and beer sales for the month of August 1983 of \$22,893.10 and \$9,491.05, respectively. The auditor's analysis of purchase invoices for August 1983 shows liquor and wine purchases of \$7,404.03 and beer purchases of \$3,029.57. A markup calculation based on these records results in a markup on liquor and wine of 309 percent and a markup on beer of 313 percent.

### SUMMARY OF PETITIONERS' POSITION

26. Petitioners maintain that Maple Leaf accurately collected, reported and remitted all taxes due throughout the audit period. Petitioners' arguments regarding the nature of the audit conducted are summarized below.

(a) The auditor made numerous errors in calculating markups on food, beer and wine and liquor.

(b) Complete records of sales and purchases for the audit period were either destroyed or discarded by a succeeding occupant of the motel and restaurant, but the samples of records which were obtained and produced at hearing establish the accuracy of the sales tax returns filed by Maple Leaf.

(c) The bar fact sheet was incomplete because Rudolph Bersani was not given an adequate opportunity to provide detailed information regarding special pricing and other promotions. Petitioners argue that the auditor violated the Division's own guidelines by not discussing the bar fact sheet with Mr. Bersani before asking him to complete it.

### CONCLUSIONS OF LAW

A. The Tax Law imposes a tax on the sale of food and drinks by restaurants and taverns (Tax Law § 1105[d][i]), and upon the rent for occupancy of a room or rooms in a hotel, except that the tax is not imposed upon a rental to a permanent resident (Tax Law § 1105[e]). A permanent resident is any occupant of a room for at least 90 consecutive days (20 NYCRR 527.9[b][8][i][a]). The vendor is obligated to "keep records of every sale...and of all amounts paid, charged or due thereon" (Tax Law § 1135[a]). Where adequate records of individual sales are not made available to the Division on audit, the Division is required to determine the amount of tax due from such information as may be available; if necessary, the tax may be estimated on the basis of external indices (Tax Law § 1138[a][1]; Matter of Carmine Restaurant v. State Tax Commn., 99 AD2d 581). Here, Maple Leaf's complete books and records were not available at the time of audit; therefore, the Division was warranted in estimating taxes due from Maple Leaf on the basis of the information available to it. Its audit proceeded along two lines. It conducted a test period and markup audit of restaurant sales, and it reviewed Maple Leaf's records to determine the taxable status of its room rentals. Each of these areas will be discussed separately.

B. Where, as here, adequate books and records are not available on audit, the Division is required to select an audit method reasonably calculated to reflect the taxes due. As there is ample precedent for the use of a test period and markup audit to estimate taxes (e.g., Matter of Korba v. New York State Tax Commn., 84 AD2d 655, 656; Matter of Carmine Restaurant, supra), the burden was upon petitioners to establish any error in the Division's audit (e.g., Matter of Carmine Restaurant, supra).

Petitioners established that the audit of alcoholic beverage sales was incorrect in several respects: the categorization of liquors and wines into lower priced bar blends and call brands and higher priced premium brands contained some errors; sparkling wines given away as promotion items were included in the Division's markup; some wines were marked up as liquors; and the serving size of a glass of wine was underestimated. However, petitioners failed to provide documentation to substantiate the pricing schedule used by Rudolph Bersani or to prove that 15 percent of bottled beer purchases were lost due to spillage and breakage. In weighing petitioners' evidence, it was considered significant that Maple Leaf's own books and records showed



markups for the August test period of 309 percent on liquor and 313 percent on beer. It is concluded that these markup figures are more accurate than those resulting from Mr. Bersani's markup test and adequately correct for the errors shown in the auditor's workpapers.

Petitioners also established that approximately one-third of the restaurant's sales were paid for with a discount coupon or represented food given away without charge. It was established that Maple Leaf participated in several discount coupon programs, that it provided its restaurant customers with free appetizers and buffets, and that it provided employees with meals as a portion of their wages. Testimony from Maple Leaf's bookkeeper, its chef and Rudolph Bersani, supported by a sample of books and records establish that the summary sheets for the audit test period accurately stated the restaurant's taxable food sales, receipts from coupons and house charges. Accordingly, the 112 percent food markup, as shown on Maple Leaf's records for the test period, is found to be accurate.

C. There is a presumption in the Tax Law that all receipts for the rental of hotel rooms are subject to tax, and the burden of proving that any such receipt is not taxable is upon the person required to collect the tax or the customer (Tax Law § 1132[c]). On audit, petitioners were unable to substantiate that certain of the rentals were to permanent residents and therefore excepted from the tax imposed by Tax Law § 1105(e). However, at hearing petitioners presented substantial evidence to support their claim of nontaxable receipts. This evidence was sufficient to verify that Maple Leaf's books and records accurately stated taxable and nontaxable rentals.

D. Petitioners presented no evidence regarding Maple Leaf's failure to pay sales tax due on its own purchase of non-food items such as ashtrays, glasses and silverware. Accordingly, the tax assessment on these purchases is sustained.

E. As a result of a Tax Appeals Bureau conference, the tax liability asserted against petitioners was reduced to \$82,619.86. The Division is directed to recalculate this liability by application of the following markups<sup>3</sup>: 112 percent for food purchases; 309 percent for liquor and wine purchases; and 313 percent for beer purchases. In addition, the Division is directed to cancel that portion of the assessment attributable to receipts on permanent motel room rentals and apartment rentals.

F. The petition of Maple Leaf Motor Lodge, Inc. and Rudolph Bersani and David Bersani, as officers, is granted to the extent indicated in Conclusions of Law "B", "C" and "E"; the notices of determination and demands for payment of sales and use taxes due issued on June 18, 1984 shall be reduced accordingly; and, in all other respects, the petition is denied.

DATED: Albany, New York  
September 29, 1988

/s/ Timothy J. Alston  
ADMINISTRATIVE LAW JUDGE

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<sup>3</sup>See Footnote 1.